Sustained Macroeconomic Stability

- In six years, Serbia has transformed to a low inflation and stable growing economy, with fiscal surplus, declining public debt, significantly reduced external imbalances and labour market recovery.
- GDP growth in 2018 (4.4%, highest in a decade) was driven by investments and exports, as well as labour market recovery. Growth trend continues in 2019, despite global slowdown.
- After moving at an average level of 2.0% in 2018 and finishing the year at the same level, inflation continued continued to move at an average of 2.0% in Q1-Q3 2019, in line with NBS forecast. Inflation expectations are anchored within the target tolerance band (3±1.5%).
- Government budget posted a surplus in 2017 and 2018 (1.1% and 0.6% of GDP, respectively), and the same trend continued in H1 2019 (surplus of 0.7% of GDP). As a result public debt share declined by over 18 pp of GDP (cumulative) since its peak in 2015, with an improved currency composition after repayment of two Eurobonds (USD 1.75 bn), and refinancing of additional USD 1.1bn on international markets in June.
- Macroeconomic stabilization and improvements to the business environment contributed to high net FDI inflows (EUR 2.5bn in January-August 2019), placing Serbia on top of global greenfield FDI performance rankings.
- Exports of goods and services retained their growth momentum in 2019 (10.8% y/y in January-August), driven by exports of services, manufactured goods and agriculture.
- Results were acknowledged by improved credit ratings in 2019 (Fitch), additionally improved outlook in 2018 (S&P) and 2019 (Moody's), by successful completion of a precautionary SBA with the IMF and a sharp decline in the country risk premium (minimum in mid-September 2019). In 2018 a Policy Coordination Instrument with the IMF has been approved, with successfully completed second review.
- After reduction of the key policy rate in July and August 2019 (each time by 25 bp), to its new lowest level of 2.5%, in September and October rate kept unchanged. Led by demand and supply factors, lending activity increased by 10.7% y/y in August 2019.
- Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 4.90% at end-August 2019, which is the lowest level since 2008 when this indicator of portfolio quality was introduced. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.
Inflation profile similar to advanced economies

- Inflation is kept firmly in check, moving around 2% on average in the past six years.
- After reaching the central target point in April, inflation slowed down to 1.1% y/y in September driven by lower prices of vegetables and oil derivatives.
- Inflation movement from the beginning of the year was mainly led by unprocessed food prices.
- Core inflation remained low and stable (September 1.3%) indicating low inflationary pressures.

Low Inflationary Pressures

Inflation is expected to remain low and stable in the next two years

- Inflation is likely to remain low and stable, with expected gradual growth and return to the target from the second half of 2020.
- The gradual growth of inflation will be driven by sustainable increase of aggregate demand and expected rise in regulated prices, while low cost pressures and inflation expectations will act in the opposite direction.
- Risks are assessed to be symmetric and related to developments in the global commodity and financial markets and, to some extent, to administered prices.
Inflation Expectations Remain Anchored within Target Tolerance Band

Short-term inflation expectations of financial institutions and corporates decreasing in the last few months …

• Short-term expectations of the financial sector and corporates have been moving within the target band for five years.

• According to Ipsos’ September survey, one-year ahead inflation expectations of the financial sector decreased to 2.0%. According to Bloomberg’s October survey, expectations of the financial sector have remained stable at 2.2%

• Expectations of the corporate sector have also fallen to 1.8% in September.

…same as medium-term inflation expectations

• Medium-term expectations of the financial sector have been moving within the target tolerance band since their monitoring began.

• Medium-term inflation expectations of the financial sector and corporates in September also edged down from August to 2.4% and 2.2%, respectively.
Strong GDP Growth on the Back of Robust Investment Activity, Exports and Labour Market Recovery

Acceleration of GDP growth and recovery in industry in H2 2019

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

- Despite momentum loss across much of the Eurozone, GDP advanced in H1 2019 (2.8% y/y), driven by all key sectors, with construction and fixed investment beating expectations.
- Growth is expected to accelerate in Q3 to 3.9% y/y driven by and further development in construction fixed investment and industrial production recovery.
- After temporary decline in H1, manufacturing is expected to recover on the back of new investment, and contribute to GDP growth in 2019.
- Even higher growth is expected in Q4 (4.0-4.5% y/y), leading to overall annual growth of 3.5% in 2019.
- Risks to GDP growth arise from global economic activity slowdown, as well as monetary policies of leading CBs and commodity prices. On the other hand, domestic factors will continue to provide strong support to economic growth, which is why we estimate risks to projection as symmetrical.
- Factors to support sustainable medium-term growth of around 4% include macroeconomic stability, improved business environment, strong private and public investment and effects of past monetary easing.
The New Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015…

- During 2015-2018, fixed investments grew at an average rate of almost 10%, with cumulative growth of around 40%.
- In 2018 investment growth picked up to 17.8% providing a key contribution to higher-than-expected GDP growth.
- Significant growth was recorded in H1 2019, on top of high base form 2018 , and the robust growth is expected in H2, due to both private and public investments.
- The share of investment in GDP reached 21.8% in 2018, and that share will continue to grow in the medium term.
- In the medium-run, investments will contribute to further rebalancing of the economy.

• Sustained macroeconomic stability, improvement in the overall business environment, rising profitability and EU accession process will work in favour of private investments in the coming years.
• Aside from private investments, public sector investments recovered as of 2015 and picked up particularly in 2018.
• A growing economy, combined with improved tax collection and responsible public spending policies, will enable the government to increase investment activity and further develop the country’s infrastructure.

…in both private and government sector

Chart 7 Fixed investment dynamics
(growth rates in %, share in %)

Chart 8 Private and government investment dynamics
(seasonally adjusted data, indices 2014=100)
Improved Business Environment Supporting High FDI Inflow

Macroeconomic stability combined with structural reforms has created a more favourable climate for FDIs...

...which are well-diversified and contributing to the country’s export potential

- Net FDIs amounted to EUR 3.2bn in 2018, marking one of the best years on record and outperforming the projection.
- In the eight months of 2019 net FDI inflow increased further (36.5% y/y over last year's high base), reaching EUR 2.5bn— a record for the calendar period.
- Serbia ranked first on Financial Times Greenfield FDI Performance Index for 2019, which looks at greenfield FDI inflows compared to the size of the economy.
- Over the past decade (and especially since 2018) an increasing share of FDI inflows has been directed to tradable sectors.
- Within manufacturing, most FDI inflows are directed to the metals, motor vehicles, food/beverage and pharmaceutical industries. This resulted in high growth of manufacturing employment, output and exports.
- FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia’s major investment partner - the European Union.

Chart 9 Net FDI (EUR bn)

Chart 10 FDI composition by sector (% of inflow)
Export growth largely continues despite Eurozone slowdown…

...but investment and oil-related imports temporarily raised the deficit in 2017 and 2018

- During 2018 CAD amounted to EUR 2.2bn (5.2% of GDP—unchanged from the previous year).
- Goods and services exports grew 10.8% in I-VIII 2019 driven by exports of services (+16.5% y/y), manufactured goods (+6.2% y/y) and agricultural products (+23.9% y/y). Eurozone demand moderation was partly compensated by increasing exports to CEE markets and new productive capacities on the supply side.
- Imports of goods and services grew 11.7% y/y in the same period, on account of higher imports of capital, intermediate as well as consumption goods.

- As of 2017 an increase in CAD / GDP ratio was recorded due to higher imports of capital and intermediate goods related to investment and industrial activity, higher oil prices as well as further growth in domestic demand.
- Since 2015 Serbia's current account deficit has been fully financed by net FDI, an indicator of long-term external sustainability.
- In the medium term, we expect CAD to be around 4-5% of GDP, while FDI inflows will remain more than sufficient to finance the CAD.
Favourable Fiscal Performance Continues

Strong fiscal adjustment since 2015 of around 8pp of GDP...

...resulted in a decline in the public debt-to-GDP ratio and its sustainability

- Improvement of the fiscal outlook in last four years was led by fiscal consolidation on expenditure side, and robust growth in revenues on account of GDP growth and improved tax collection.
- Fiscal balance remained in surplus in 2018 (0.6% of GDP) and the positive trend continues in H1 2019 with a surplus of 0.7% of GDP.
- Public investments in H1 continued double digit growth on top of high base from 2018 (when they grew at a rate of around 50% y/y, reaching 3.9% of GDP). They are expected to exceed 4% of GDP in 2019.

- The declining trend of public debt continued in 2019 (51.9% of GDP in August).
- The Government’s Fiscal Strategy entails a medium-term deficit target of 0.5% of GDP, consistent with steady debt reduction and sustainability.
- Public debt dinarisation picked up from 20.9% (end-2016) to 27.4% in August 2019 due to two Eurobond repayments (USD 1.75 bn).
- In June Serbia issued a 10y EUR 1bn Eurobond at 1.619% and repaid USD-denominated bonds in the same amount, thereby reducing exchange rate and rollover risk.
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

Key reform areas in the last four years:
- Construction sector;
- Labor market;
- Tax administration;
- Financial sector;
- Contract enforcement and resolving insolvency.

Key deliverables:
- Law on Planning and Construction (2014) and Law on Investment (2015) – streamlined construction permit procedures (one-stop-shop and electronic construction permits), doubling the number of construction permits and increasing the share of construction in GDP.
- New Labor Law (2014) – improved flexibility and job creation. On top of that, the National Employment Strategy & Reform Program improved job matching services and training and provided subsidies to disadvantaged people and self-employment. Reforms contributed to an increase in private sector employment by more than 200 thousand people (17.5%), almost half of which in manufacturing industry, followed by private sector services and the construction sector.
- Tax Administration reform – led to a significant increase in revenue collection and better than planned fiscal results.
- NPL Resolution Strategy (NBS and government action plans) – the share of NPLs declined more than 70% (from 22.2% in August 2015 to 4.90% in August 2019). Narrowing was most evident with corporates – the share of NPLs was reduced from 25.9% to 4.1% in the same period.
- Private bailiff system (2013) and New Bankruptcy Law (2014).
Key Policy Rate kept at 2.5%, its lowest level in the inflation targeting regime

After reduction in July and August, the key policy rate kept unchanged at 2.5%

FX required reserve ratio has remained unchanged since early 2016

The decision takes into account the following factors:

• Medium-term inflation projection and other macroeconomic indicators in the domestic and international environment and the need to fully analyze the effects of past monetary policy easing.

• Caution in the monetary policy pursuit which is still warranted, mostly due to the developments in the international environment, as international financial and commodity markets are largely affected by uncertain trade policies of leading world economies and global economic slack.

• The resilience of the Serbian economy to potential negative effects from the international environment has strengthened as a result of reduced internal and external imbalances, favorable macroeconomic outlook, as well as an increasing level of FX reserves.

- Last time FX RR ratio was reduced in early 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).
- RR is an important monetary policy tool (in September 2019 RR amounted to EUR 2.0 bn and RSD 186.1 bn).
- NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration at higher rate on dinar RR vs FX RR (i.e. 1.00% on RSD RR, while no remuneration is applied on FX RR).
The Effects of NBS Monetary Policy are Reflected in Lower Costs of Government and Private Sector Financing

Interest rates on dinar government securities have slided to new minimums …

… while interest rates on private sector loans are close to their lowest levels

- The yield rate fall is accompanied by an extension of the yield curve maturity to 10 years; the weighted average interest rate on domestic bonds has dropped from 13.7% (Dec 2012) to 5.5% (October 2019), with the share of long-term securities (5+ year maturity), increasing from 2% to over 70%.

- During 2019 Serbia has issued benchmark bonds (maturity of 3 and 7 years); in the latest auctions, June (3y) and October (7y), yields fell to/kept at 3.4%.

- Successful Eurobond issuance (EUR 1 bn, 10y, yield of 1.6%) in June 2019 has confirmed the investors confidence in undertaken reforms in previous years.

- Since the beginning of monetary policy relaxation cycle (May 2013), dinar lending interest rates fell sharply. In August 2019, dinar interest rate for corporate sector stood at 5.1% (down by 11.3 pp), while households dinar interest rates recorded new minimum of 9.7% (down by 10.8 pp).

- The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

- In the observed period, a sharp fall in the country risk premium and monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
Lower costs of financing and sustainable economic growth support domestic lending …

... as well as to Growth of Credit Activity

... and the positive tendencies in the credit market are also confirmed by the results of the bank lending survey

- In August 2019, domestic lending growth accelerated to 10.7% y/y, led by pick up of corporate loans to 11.9% y/y, while households lending slowed down slightly slowdown to 9.3% y/y.
- Banks continued with their NPL resolution efforts - excluding the effect of NPL write-offs and sales, total lending growth reached 10.7% y/y in August 2019.
- Further growth of lending activity is expected in the coming period, as a result of sustainable economic growth, improved conditions in the labor market, effects of past monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

- After relaxation in 2017 and H1 2018 corporate lending standards remained unchanged. Stronger competition, lower cost of funding, positive expectations regarding the overall economic situation and greater risk appetite should contribute to the easing of corporate credit standards in Q3. Similar conditions prevail in the household sector.
- Main factors driving credit demand of corporate / household sector are Capex and working capital financing needs / real estate acquisition and refinancing of liabilities.
Serbia’s Credit Rating Improvement and Investor Confidence Growth

After new all-time low in September, Serbia’s risk premium remains among the lowest in the region

The dinar remained relatively stable against the euro in 2018 and since the start of 2019

- The risk premia of emerging markets have been declining since the year beginning as investor sentiment improved due to the expected monetary policy easing of the leading central banks. Serbia’s risk premium reached its historical low level in September (49 bp), and recorded second-biggest fall in the region ytd, indicating that the decline was also driven by domestic factors. This confirms investors’ confidence in favourable macroeconomic prospects.

- In September 2019 Fitch improved Serbia’s rating from BB to BB+, sending a positive signal to investors.

- In September Moody’s upgraded the outlook for credit rating to 'positive' from 'stable'.

- The appreciation pressures that prevailed in the previous two years, were dominant since the start of 2019 as well. Strengthening of the dinar is stimulated by better Serbia’s macroeconomic fundamentals, good performance and favorable growth prospects, which contributed to FX inflow on account of FDI and elevated non-resident investment in long-term dinar government securities.

- In order to maintain the relative stability of the dinar, the National Bank of Serbia was buying FX in periods of strong and concentrated appreciation pressures, acting proactively and bolstering the FX reserves, thus enhancing the resilience of the domestic financial system to external risks.
Serbia One Step Away from Investment Grade – Fitch Upgrades Serbia’s Rating from BB to BB+

• The rating upgrade reflects the preserved price stability and fiscal discipline, continuous strengthening of the banking sector and improvement of the business environment. Also, the Agency expects economic growth to continue to be investment- and exports-driven which, according to Fitch, should result from the commitment of Serbian authorities to the continuity of the economic policy.

  – Fitch particularly emphasizes the NBS’s success in maintaining low and stable inflation. It expects inflation to remain firmly under control, within the NBS target tolerance band. Agency also stresses positive trends in the banking sector, underlining the sharp reduction in the NPL share in total loans to below 5.0%, solid capitalisation of the banking sector, and two-digit lending growth which supports economic growth.

  – Fitch projects that the general government budget will remain in a mild surplus this year, even against the background of robust growth in government capital investment and a planned increase in wages and pensions, owing to a stable rise in budget revenue in an environment of economic expansion. As a result of balanced public finances, Fitch assesses that the share of general government public debt in GDP will fall to 46.2% in 2021, and to 37.4% in the next ten-year period.

  – The Agency forecasts a pick-up in Serbia’s GDP growth in the period ahead, driven by the increasingly positive labour market dynamics and the rise in construction boosted by government investment in infrastructure. The continued strong FDI inflow is also emphasized along with the maintained rise in exports despite the euro area economic slack.
Indicators of Dinarisation are on the Rise

Macroeconomic stability contributing to dinarisation process

The growth of dinar loans to households accompanied by higher dinar savings

- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.

- The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 27.4% in August 2019).

- Dinarisation of corporate and household sector deposits rose by 13.7 pp compared to end-2012 and currently stands at 33.0% (August 2019), while dinarisation of corporate and household sector receivables rose by 5.5 pp to 33.5% (August 2019).

- Over the past years, dinarisation of household receivables had a firm upward trend – an upsurge from 35.1% (2012) to the maximum of 55.2% (August 2019). This positive trend is a result of a sharp drop in dinar interest rates, low and stable inflation, as well as NBS measures aimed to support dinarisation.

- Dinar savings of households (residents) recorded strong growth of 22.2% in 2018, which is also continued in 2019. In eight months, it increased by RSD 11.0 bn to a new maximum of RSD 71.5 bn in August (or RSD 72.2 bn including non-residents).

- Dinarisation process is additionally supported by the issuance of the dinar bonds by EBRD (December 2016) and Erste bank (February 2019).
Traditional Banking
Mostly Financed by Domestic Deposits

Adequate structure of banking sector assets

Improving the quality of the banking sector assets

- Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around of one-fifth of the total banking sector net assets (17.5% at the end of August 2019).
- Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 47% and 27%, respectively at the end of August 2019.
- Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 2.5% of regulatory capital at end of August 2019.

- Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.
- At end-August 2019, the NPL ratio was 4.90%, with the maintenance of relatively high coverage by both, IFRS provisions (60.9%).
- The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of June 2019 amounted to 13.8%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 35.8% of the total assets of the banking sector in August 2019.
- The loan to deposit ratio that at the end of August 2019 amounted 92.1%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Reduced Food Price Volatility Contributing to Low and Stable Inflation

- Historically, short-term volatility of headline inflation was mainly driven by food prices.
- Core inflation remained low and stable hovering around 1% in 2018, confirming low inflationary pressures. In 2019, it has been moving close to the lower bound of the target tolerance band (1.5%).
Growth Structure more Favourable than Pre-Crisis

Pre-crisis GDP growth was driven by consumption, the trend reversed after the crisis in favour of investments and exports.

In the next five years, Serbia will gradually converge towards more developed countries in terms of GDP composition.

- Prior to the crisis, high capital inflows led to consumption-based growth which resulted in increased external imbalances. With the first wave of the crisis, this trend reversed. Growth was slower, but more sustainable and driven by net exports and investments.
- Large-scale investments in the automobile and oil industries (2011–2012) have helped the economy to rebalance.
- The new investment cycle that began in 2015 is more diversified, and is leading to further rebalancing of the economy and sustainable growth.

- As a result of adequate policy mix, GDP growth will remain broad-based and sustainable.
- Consumption will continue to grow, but slower than the total GDP, creating space for more investment.
- In the medium-run, fixed investments will increase their share in GDP, while exports of goods and services are likely to approach 70% of GDP.
- Implementation of structural reforms, improvement in the investment climate and the EU accession process created a foundation for healthy growth.
Labour Market Recovery and Productivity Growth

The unemployment rate has reached a minimum in Q2 2019

- In Q2 2019, the unemployment rate reached its historically lowest value, at 10.3%, down 1.6 p.p. lower than in the same period of the previous year.

- Favourable trends in the formal labour market come from the private sector, where employment increased by 16.4% (July 2019/December 2014) - mainly in manufacturing, private sector services and construction.

Increasing contribution of total factor productivity to Serbian GDP growth

- In the period as of 2015, a positive contribution to GDP growth came from capital, labour and TFP.

- Growth acceleration in 2017-2018 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2016, compensated by a faster growth of the capital stock.

- In the medium term, we expect still lower contribution from labour, a higher capital contribution due to structural reforms, while TFP contribution will increase further to 2 pp supporting income convergence to developed countries.
Chart 35 **Goods imports by country in H1 2018/2019**
(EUR mn and % of total)

<table>
<thead>
<tr>
<th>Country</th>
<th>H1 2018</th>
<th>H1 2019</th>
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<tbody>
<tr>
<td>DEU</td>
<td>8.9%</td>
<td>8.6%</td>
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<td>RUS</td>
<td>8.8%</td>
<td>8.6%</td>
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<td>ITA</td>
<td>12.7%</td>
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<td>CHN</td>
<td>4.7%</td>
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<tr>
<td>HUN</td>
<td>3.9%</td>
<td>3.5%</td>
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<tr>
<td>TUR</td>
<td>2.9%</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

Euro Area: 41.3% 38.9%
CESEE: 22.4% 22.5%
CIS: 10.0% 11.7%

12.7% of total imports in H1 '19

Chart 36 **Goods exports by country in H1 2018/2019**
(EUR mn and % of total)

<table>
<thead>
<tr>
<th>Country</th>
<th>H1 2018</th>
<th>H1 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEU</td>
<td>7.4%</td>
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<td>ITA</td>
<td>5.2%</td>
<td>4.5%</td>
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<tr>
<td>BH</td>
<td>4.2%</td>
<td>3.7%</td>
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<tr>
<td>ROM</td>
<td>3.3%</td>
<td>3.5%</td>
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<tr>
<td>RUS</td>
<td>3.3%</td>
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<td>AUT</td>
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<td>3.3%</td>
</tr>
<tr>
<td>CZE</td>
<td>3.3%</td>
<td>3.3%</td>
</tr>
</tbody>
</table>

Euro Area: 43.1% 42.3%
CESEE: 38.4% 38.7%
CIS: 6.8% 6.4%

11.4% of total exports in H1 '19

Chart 37 **External Demand Indicator**
(long-term average = 100)

[Graph showing external demand indicator with data points for each year from 2009 to 2019]

Source: European Commission, NBS

Chart 38 **Real Effective Exchange Rate Development**
(2005=100)

[Graph showing real effective exchange rate development with data points for each year from 2010 to 2019]

*Growth indicates appreciation.
Legal Framework for Banking Supervision

- **Domestic regulatory framework for banking supervision is based on Basel III standards:**
  - Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
  - Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
  - The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks’ exposure to liquidity risk, further strengthening of the market discipline and transparency of banks’ operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
  - So far no issues have been identified in the application of Basel III standards;
  - NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.

- In December 2017 **regulation governing risk management by banks was amended** with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).

- Accounting and prudential regulations were timely adjusted in order to **enable the implementation of IFRS 9 in banks from 1st of January 2018.**

- Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.
The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

Effect of strategy on NPL stock

- Aggregate decrease of NPL level in August 2015 – August 2019 amounts to RSD 310.1 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 4.90 % at end-August 2019. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 17.35 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it’s upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.
Capital Buffers – Implementation of Macroprudential Policy Measures

- Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
- These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
- The following capital buffers are used in the Republic of Serbia:
  - Capital conservation buffer;
  - Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  - Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  - Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
- The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
- Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017 and 2018, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

- After 2018 drop in share of NPLs of 4.15 pp, noticeable downward trend continued in 2019, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.

- Fall was widespread and recorded in all sectors, of which most prominent was within construction.

- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

### NPL data, August 2019

<table>
<thead>
<tr>
<th>Category</th>
<th>Gross Loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporates</td>
<td>9.1</td>
<td>0.4</td>
<td>4.1</td>
</tr>
<tr>
<td>Natural persons</td>
<td>9.1</td>
<td>0.4</td>
<td>4.2</td>
</tr>
<tr>
<td>of which: households</td>
<td>8.2</td>
<td>0.3</td>
<td>4.1</td>
</tr>
<tr>
<td>Corporates in bankruptcy proceedings</td>
<td>0.2</td>
<td>0.2</td>
<td>99.1</td>
</tr>
<tr>
<td>Other</td>
<td>1.9</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>20.3</td>
<td>1.0</td>
<td>4.9</td>
</tr>
</tbody>
</table>
## Serbia’s Economic Outlook

### Serbia

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</thead>
<tbody>
<tr>
<td>Real GDP, y-o-y %</td>
<td>5.7</td>
<td>-2.7</td>
<td>0.7</td>
<td>2.0</td>
<td>-0.7</td>
<td>2.9</td>
<td>-1.6</td>
<td>1.8</td>
<td>3.3</td>
<td>2.0</td>
<td>4.4</td>
<td>3.5</td>
<td>4.0</td>
</tr>
<tr>
<td>Private consumption, in %</td>
<td>4.5</td>
<td>-3.3</td>
<td>-0.6</td>
<td>1.4</td>
<td>-1.7</td>
<td>-1.7</td>
<td>-0.1</td>
<td>-0.3</td>
<td>1.3</td>
<td>1.9</td>
<td>3.1</td>
<td>3.3</td>
<td>3.6</td>
</tr>
<tr>
<td>Private investment,¹ in %</td>
<td>14.4</td>
<td>-23.6</td>
<td>-7.9</td>
<td>7.5</td>
<td>15.1</td>
<td>-7.7</td>
<td>-5.6</td>
<td>3.5</td>
<td>2.7</td>
<td>10.1</td>
<td>13.6</td>
<td>7.8</td>
<td>8.5</td>
</tr>
<tr>
<td>Government consumption, in %</td>
<td>3.5</td>
<td>-1.7</td>
<td>0.0</td>
<td>1.6</td>
<td>0.4</td>
<td>-2.1</td>
<td>0.9</td>
<td>-3.7</td>
<td>1.2</td>
<td>3.3</td>
<td>3.7</td>
<td>2.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Government investment, in %</td>
<td>-16.4</td>
<td>-16.6</td>
<td>0.0</td>
<td>-7.8</td>
<td>7.6</td>
<td>-35.8</td>
<td>13.6</td>
<td>14.0</td>
<td>22.0</td>
<td>-6.4</td>
<td>43.1</td>
<td>17.3</td>
<td>8.1</td>
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<tr>
<td>Exports, in %</td>
<td>12.6</td>
<td>-11.5</td>
<td>16.9</td>
<td>5.6</td>
<td>2.9</td>
<td>18.0</td>
<td>4.3</td>
<td>9.4</td>
<td>11.9</td>
<td>8.2</td>
<td>8.3</td>
<td>10.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Imports, in %</td>
<td>10.1</td>
<td>-21.9</td>
<td>-0.1</td>
<td>7.2</td>
<td>-0.6</td>
<td>6.5</td>
<td>5.1</td>
<td>4.0</td>
<td>6.7</td>
<td>11.1</td>
<td>11.6</td>
<td>10.5</td>
<td>10.4</td>
</tr>
<tr>
<td>Unemployment Rate, in %⁴</td>
<td>13.6</td>
<td>16.1</td>
<td>19.2</td>
<td>23.0</td>
<td>23.9</td>
<td>22.1</td>
<td>19.2</td>
<td>17.7</td>
<td>15.3</td>
<td>13.5</td>
<td>12.7</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Nominal Wages, in %⁵</td>
<td>18.0</td>
<td>9.0</td>
<td>7.6</td>
<td>11.2</td>
<td>9.0</td>
<td>6.2</td>
<td>1.4</td>
<td>-0.2</td>
<td>3.7</td>
<td>3.9</td>
<td>6.5</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Money Supply (M3), in %</td>
<td>9.8</td>
<td>21.5</td>
<td>12.9</td>
<td>10.3</td>
<td>9.4</td>
<td>4.6</td>
<td>7.6</td>
<td>6.6</td>
<td>11.6</td>
<td>3.6</td>
<td>14.5</td>
<td>n/a</td>
<td>n/a</td>
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<tr>
<td>CPI,² in %</td>
<td>8.6</td>
<td>6.6</td>
<td>10.3</td>
<td>7.0</td>
<td>12.2</td>
<td>2.2</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
<td>3.0</td>
<td>2.0</td>
<td>chart 2</td>
<td></td>
</tr>
<tr>
<td>Current Account Deficit BPM-6 (% of GDP)</td>
<td>20.0</td>
<td>6.3</td>
<td>6.5</td>
<td>10.3</td>
<td>10.9</td>
<td>5.8</td>
<td>5.6</td>
<td>3.5</td>
<td>2.9</td>
<td>5.2</td>
<td>5.2</td>
<td>5.5</td>
<td>5.0</td>
</tr>
</tbody>
</table>

¹ Excluding the effect of change in inventories
² Inflation figures in the table represent Dec on Dec inflation: (Pt/Pt-12)*100-100
³ Latest data
⁴ Labour Force Survey. Since 2014, data are revised according to the new LFS methodology.
⁵ Since 2017, nominal wages published according to the new methodology.

*NBS forecast
## Banking Sector Overview

### Serbia

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of banks¹</strong></td>
<td>33</td>
<td>33</td>
<td>32</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>29</td>
<td>27</td>
<td>26</td>
</tr>
<tr>
<td><strong>Employees</strong></td>
<td>29,887</td>
<td>29,228</td>
<td>28,394</td>
<td>26,380</td>
<td>25,106</td>
<td>24,257</td>
<td>23,055</td>
<td>21,598</td>
<td>20,181</td>
<td>19,630</td>
</tr>
<tr>
<td><strong>Branches</strong></td>
<td>2,487</td>
<td>2,383</td>
<td>2,243</td>
<td>1,989</td>
<td>1,787</td>
<td>1,730</td>
<td>1,719</td>
<td>1,627</td>
<td>1,598</td>
<td>1,605</td>
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<tr>
<td><strong>HHI Assets</strong></td>
<td>629</td>
<td>664</td>
<td>678</td>
<td>741</td>
<td>794</td>
<td>796</td>
<td>813</td>
<td>813</td>
<td>779</td>
<td>800</td>
</tr>
<tr>
<td><strong>Share of foreign banks, %</strong></td>
<td>73.5</td>
<td>74.1</td>
<td>75.2</td>
<td>74.5</td>
<td>76.1</td>
<td>76.7</td>
<td>76.9</td>
<td>75.4</td>
<td>76.4</td>
<td>76.7</td>
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<tr>
<td><strong>Assets (net), EUR m</strong></td>
<td>24,015</td>
<td>25,211</td>
<td>25,322</td>
<td>24,827</td>
<td>24,545</td>
<td>25,059</td>
<td>26,253</td>
<td>28,440</td>
<td>31,931</td>
<td>33,280</td>
</tr>
<tr>
<td><strong>Capital, EUR m</strong></td>
<td>4,720</td>
<td>5,104</td>
<td>5,198</td>
<td>5,186</td>
<td>5,198</td>
<td>5,107</td>
<td>5,090</td>
<td>5,122</td>
<td>5,631</td>
<td>5,725</td>
</tr>
<tr>
<td><strong>Loans (gross), EUR m</strong></td>
<td>15,324</td>
<td>17,204</td>
<td>17,273</td>
<td>16,140</td>
<td>16,170</td>
<td>16,175</td>
<td>16,442</td>
<td>17,565</td>
<td>19,406</td>
<td>20,292</td>
</tr>
<tr>
<td><strong>Of which gross NPL, EUR m</strong></td>
<td>2,592</td>
<td>3,275</td>
<td>3,217</td>
<td>3,448</td>
<td>3,483</td>
<td>3,491</td>
<td>2,800</td>
<td>1,730</td>
<td>1,105</td>
<td>995</td>
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<tr>
<td><strong>Gross NPL ratio, %</strong></td>
<td>16.9</td>
<td>19.0</td>
<td>18.6</td>
<td>21.4</td>
<td>21.5</td>
<td>21.6</td>
<td>17.0</td>
<td>9.8</td>
<td>5.7</td>
<td>4.9</td>
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<tr>
<td><strong>IFRS impairment of NPLs</strong></td>
<td>47.2</td>
<td>51.0</td>
<td>50.0</td>
<td>50.9</td>
<td>54.9</td>
<td>62.3</td>
<td>67.8</td>
<td>58.1</td>
<td>60.2</td>
<td>60.9</td>
</tr>
<tr>
<td><strong>Deposits, EUR m</strong></td>
<td>14,263</td>
<td>14,584</td>
<td>14,936</td>
<td>15,067</td>
<td>15,637</td>
<td>16,523</td>
<td>18,242</td>
<td>19,926</td>
<td>23,115</td>
<td>23,827</td>
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<tr>
<td><strong>Pretax Income², EUR m</strong></td>
<td>241.0</td>
<td>12.0</td>
<td>102.5</td>
<td>-18.0</td>
<td>29.0</td>
<td>80.0</td>
<td>172.0</td>
<td>579.8</td>
<td>640.6</td>
<td>409.5</td>
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<tr>
<td><strong>CAR³, %</strong></td>
<td>19.9</td>
<td>19.1</td>
<td>19.9</td>
<td>20.9</td>
<td>20.0</td>
<td>20.9</td>
<td>21.8</td>
<td>22.6</td>
<td>22.3</td>
<td>23.2</td>
</tr>
<tr>
<td><strong>CET1 ratio % ³,⁴</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>21.5</td>
<td>21.1</td>
<td>22.1</td>
</tr>
<tr>
<td><strong>Leverage % ³,⁴</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11.1</td>
<td>12.6</td>
<td>13.8</td>
</tr>
<tr>
<td><strong>Liquidity ratio</strong></td>
<td>1.0</td>
<td>2.2</td>
<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
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<tr>
<td><strong>Liquidity coverage ratio⁴, %</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>239.5</td>
<td>213.3</td>
<td>216.2</td>
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<tr>
<td><strong>FX ratio, %</strong></td>
<td>3.9</td>
<td>6.2</td>
<td>5.5</td>
<td>4.4</td>
<td>3.9</td>
<td>4.4</td>
<td>2.7</td>
<td>2.9</td>
<td>4.5</td>
<td>2.5</td>
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<tr>
<td><strong>ROA², %</strong></td>
<td>1.1</td>
<td>0.0</td>
<td>0.4</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
<td>2.1</td>
<td>2.1</td>
<td>1.9</td>
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<tr>
<td><strong>ROE², %</strong></td>
<td>5.4</td>
<td>0.2</td>
<td>2.0</td>
<td>-0.4</td>
<td>0.6</td>
<td>1.6</td>
<td>3.4</td>
<td>10.6</td>
<td>11.3</td>
<td>10.6</td>
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<tr>
<td><strong>Net interest margin⁵, %</strong></td>
<td>4.6</td>
<td>4.6</td>
<td>4.3</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.3</td>
</tr>
</tbody>
</table>

¹ The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodina on 6 April 2013, from Privredna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK bank on 23 December, 2017. Piraeus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska bank was merged to OTP bank 25. April 2019 (consolidated under Vojvodanska brand).

² Without Agrobanka at the end of 2011: Pretax profit €296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit €230m; ROA 1.0; ROE 4.7

³ The last available data of 30.06.2019

⁴ Introduced by the implementation of Basel 3 and monitored from 30 June 2017

⁵ Net interest margin to average total asset